

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA LEGISLATURE AND THE COUNCIL ON THE UMJINDI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

I was engaged to audit the accompanying financial statements of the Umjindi Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

Accounting officer's responsibility for the financial statements

The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Accumulated surplus

The municipality could not provide an explanation or sufficient appropriate audit evidence to support a difference of R202 323 652 between the opening balance of the accumulated surplus as at 1 July 2008 as disclosed in the statement of changes in net assets in the financial statements for the 2009-10 financial year and the audited annual financial statements of the prior year. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that this difference could be supported and justified. The municipality also did not provide any explanation in the annual financial statements on this difference.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of the accumulated surplus balance of R439 681 890 of the municipality as at 30 June 2010, the 2009 balance of R444 590 044 and the 2008 balance of R456 688 995.

Cash and cash equivalents

The municipality could not provide sufficient appropriate audit evidence to support the reconciling items on the year-end bank reconciliation amounting to R2 215 684 and credited to trade and other payables from exchange transactions as well as R576 311 still reflected on the year-end bank reconciliation.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, valuation and allocation of cash and cash equivalents stated at R3 135 032 (credit) for the municipality as disclosed in the statement of financial position and cash flow statement as at 30 June 2010.

General expenses

The municipality recognised expenditure based on orders issued. This practice was not in accordance with SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, which requires expenditure and services to be recorded when an item meets the definition of an expense and it is probable that any future economic benefit or service potential associated with the item will flow to or from the municipality and the item has a cost of value that can be reliably measured. As a result, expenses and trade payables were overstated by an amount of R2 281 968.

Supporting invoices could not be provided for an audit difference of R34 117 912 relating to general expenses, due to a lack of a proper filing system. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that general expenses had occurred and were accurately recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, accuracy, cut-off and classification of general expenses of R34 441 356 as disclosed in the statement of financial performance.

Property, plant and equipment

I was unable to obtain sufficient appropriate audit evidence or obtain adequate assurance from performing alternative procedures, as to the existence, completeness, valuation and allocation and the municipality's rights to property, plant and equipment to the amount of R351 869 221, as disclosed in the statement of financial position and note 5 to the financial statements, due to the following:

- The existence of water and sewerage infrastructure assets amounting to R21 948 827 could not be confirmed, due to the incompleteness of the asset register.
- I was unable to obtain sufficient appropriate audit evidence to support additions to property, plant and equipment amounting to R22 113 852 as disclosed in note xxx to the financial statements, as the municipality could not provide supporting invoices amounting to R3 259 338.
- I was unable to obtain sufficient appropriate audit evidence to support journal entries of R4 977 521 and R2 714 233 debited and credited to property, plant and equipment and the accumulated surplus, respectively.

Property, plant and equipment as at 30 June 2010, to the amount of R351 869 221, as disclosed in the statement of financial position and note 5 to the financial statements, were understated by R28 572 939, due to the following misstatements:

- Electricity infrastructure assets amounting to R29 797 471 included in the valuation roll of the municipality were not included in the financial statements of the municipality and property, plant and equipment was therefore understated by R29 797 471.
- In terms of paragraph 76 of SA Standard of GRAP, GRAP 17, *Property, plant and equipment* (GRAP 17), the carrying amount of an item of property, plant and equipment shall be derecognised on disposal or when no future economic benefits or service potential is expected from its use or disposal. I identified assets amounting to R658 342 that had been scrapped or sold but not removed from the financial records of the municipality and the balance sheet is therefore overstated by this amount.
- In terms of paragraph 11 of GRAP 17, the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the municipality and the cost of fair value of the item can be measured reliably. I identified items of property, plant and equipment amounting to R566 190 that had been expensed but not capitalised and property, plant and equipment is therefore understated and expenses as well as accumulated surplus overstated and understated, respectively, by this amount.

Investment property

As disclosed in note 4 to the financial statements, investment properties were valued in accordance with the municipal valuation roll dated 1 July 2008. The value of municipal properties according to this valuation roll was R21 117 000 lower than the value recorded in the annual financial statements. No supporting documentation was available for the difference in value. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of investment property stated at R119 035 000 in note 4 to the annual financial statements.

Property rates and service charges revenue

The municipality could not provide sufficient appropriate audit evidence to support the completeness of refuse and sewerage revenue recorded in the annual financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that refuse and sewerage revenue of R11 583 391, included in service charges revenue of R68 730 720, as disclosed in the statement of financial performance had been properly recorded.

The municipality could not provide sufficient appropriate audit evidence to support the accuracy of property rates revenue recorded in the annual financial statements.

I identified an overstatement amounting to R811 005 on rates revenue inaccurately recorded.

The municipality recognised electricity revenue to the amount of R152 748 from interdepartmental transactions, which should have balanced out to R0.

The municipality overstated prepaid electricity revenue included in service charges in the annual financial statements by an amount of R322 374.

Other income

The municipality could not provide sufficient appropriate audit evidence to support the completeness of other income revenue recorded in the annual financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that other income revenue of R2 814 378, as disclosed in the statement of financial performance, had been completely recorded.

Government grants and subsidies

The municipality recognised revenue to the amount of R543 013 on conditional grants overspent and debited other receivables from non-exchange transactions. Consequently, government grants and subsidies recorded at R52 307 332 and other receivables from non-exchange transactions disclosed in the financial statements were overstated by R543 013.

Rental of facilities and equipment revenue

The municipality could not provide sufficient appropriate audit evidence to support the rental of facilities and equipment revenue. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, occurrence and accuracy of rental of facilities and equipment revenue of R503 442, as disclosed in the statement of financial performance.

Interest received from investments

The municipality overstated interest received – investment revenue in the annual financial statements by an amount of R103 315. Consequently, interest received from investments stated at R659 325, as disclosed in the statement of financial position, was overstated by R103 315.

Consumer debtors

In accordance with Directive 5 issued by the Accounting Standards Board, the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133) *Financial Instruments: Recognition and measurement* should be applied in determining impairment provisions on consumer debtors. The standard requires the use of discounted cash flow projections on an individual consumer debtor basis to determine impairment. The municipality did not apply these requirements to determine the impairment in accordance with the standard. The information technology system used by the municipality did not allow me to calculate a provision in accordance with the standard. The age analyses indicated an additional R5 747 855 to be provided if all debtors over 60 days were included. The ageing of the age analyses provided was also inaccurate.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of consumer debtors stated at R13 691 936 in the annual financial statements.

Value-added tax payable

The municipality could not provide sufficient appropriate audit evidence to support an amount of R8 417 912 included as a value-added tax (VAT) payable in the annual financial statements. This balance could not be supported by a reconciliation or outstanding VAT 201 forms. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence and valuation of the VAT payable stated at R8 417 912 in the statement of financial position.

Trade and other payables from exchange transactions

The municipality could not provide sufficient appropriate audit evidence to support the completeness of trade payables recorded in the annual financial statements. The municipality could not provide sufficient appropriate audit evidence to support an amount of R1 474 966 included in retentions in note 22 to the annual financial statements. The municipality could also not provide sufficient appropriate audit evidence to support an amount of R3 354 464 included as unidentified deposits in note 22 to the annual financial statements.

There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that retentions and unidentified deposits had been correctly recorded.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of trade payables stated at R134 555 as well as the completeness, occurrence and accuracy of retentions and unidentified deposits amounting to R1 474 966 and R3 354 464, respectively, included in trade and other payables from exchange transactions, stated at R10 495 005 in the annual financial statements.

Provisions

The municipality could not provide sufficient appropriate audit evidence to support an amount of R1 047 553 relating to performance bonus provisions included in provisions in note 21 to the annual financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance on performance bonus provisions. In addition, this amount should have been included under trade and other payables from exchange transactions and not provisions.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence and accuracy of performance bonus provisions amounting to R1 047 553 included in provisions, stated at R3 843 826 in the annual financial statements.

Retirement benefit obligation

In accordance with Directive 5 issued by the Accounting Standards Board, the South African Statement of Generally Accepted Accounting Practice, IAS 19 *Employee Benefits* should be applied in the measurement and recognition of retirement benefit obligations. The standard requires the use of an actuarial valuation method, i.e. the projected credit unit method, to value the obligation and recognise the amount and various other disclosure requirements in the annual financial statements. The municipality did not obtain an actuarial valuation on the obligation and did not comply with the recognition and measurement requirements of the standard.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence and valuation of retirement benefit obligations stated at R3 449 158 in the annual financial statements.

Project commitments

The municipality could not provide sufficient appropriate audit evidence as to the completeness, existence and accuracy of R7 419 353 relating to project commitments disclosed in note 49 to the annual financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance on project commitments.

Inventory

The municipality could not provide sufficient appropriate audit evidence as to the completeness, existence and accuracy of R2 716 570 recorded as inventory in the statement of financial position. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance on inventory.

Irregular expenditure

Contrary to the requirements of schedule 6 of the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA), the municipality spent R2 978 473 of its section 6 allocations on operational costs that did not meet the conditions of the allocation. The municipality did not disclose this irregular expenditure in the annual financial statements as required by section 125(2)(d) of the MFMA.

Disclaimer of opinion

Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matter

I draw attention to the matter below. My opinion is not modified in respect of this matter:

Restatement of corresponding figures

As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of an error discovered during the current financial year in the financial statements of the municipality at, and for the year ended, 30 June 2009. The error resulted from the application of Directive 4 on fixed assets.

Additional matter

I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

The supporting schedules on pages XX to XX do not form part of the financial statements and have therefore not been audited.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA and the Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), and financial management (internal control).

Predetermined objectives

Material findings on the report on predetermined objectives, as set out on pagesto..., are reported below:

Non-compliance with regulatory and reporting requirements

Inadequate reporting against predetermined objectives, indicators and targets

The performance report included in the annual report of the municipality was not prepared in terms of section 46 of the MSA and section 121(3)(c) of the MFMA. The performance report only included a summary of achievements as well as measurements on backlogs.

Reliability of information

The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the municipality, i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Have amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?
- **Completeness:** Have all actual results and events that should have been recorded been included in the reported performance information?

The following audit finding relates to the above criteria:

No supporting documentation

Sufficient appropriate audit evidence in relation to any of the selected programmes or objectives could not be obtained. There were also no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information.

Compliance with laws and regulations

Municipal Finance Management Act

Accounting officer and municipal officials did not adhere to their statutory responsibilities

- Contrary to the requirements of section 123(1)(f) of the MFMA, the municipality did not disclose funds destined for the municipality in terms of DoRA delayed or withheld and the reasons advanced to the municipality for such delay or withholding.

INTERNAL CONTROL

I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA and the MSA, but not for the purpose of expressing an opinion on the effectiveness of internal control.

The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

The accounting officer of the municipality did not exercise oversight responsibility over reporting, compliance with laws and regulations, and internal control. Actions were not taken to address risks relating to the achievement of complete and accurate financial and performance reporting. Control weaknesses were not analysed and appropriate follow-up actions were not taken to address root causes. Internal and external audit findings were not addressed.

- **Financial and performance management**

Management and staff of the municipality did not fulfil their duties and responsibilities and the municipality did not have competent individuals who understood the financial reporting framework and performance management requirements. Pertinent information was not identified and captured in a form and time frame to support financial and performance testing. The financial statements were subject to material amendments resulting from the audit, which indicated that the financial statements and other information to be included in the annual report were not reviewed for completeness and accuracy prior to submission for auditing. Requested information could not be supplied without significant delay. General information technology controls were not designed to maintain the integrity of the information systems and the security of the data, while manual or automated controls were not designed to ensure that the transactions had occurred, had been authorised, and had been completely and accurately processed.

- **Governance**

Segregation of duties to prevent fraudulent data and asset misappropriation was not adequate. Ongoing monitoring and supervision were not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting, while financial statements were not reviewed prior to submission for auditing.

Auditor-General
Nelspruit

30 November 2010



AUDITOR-GENERAL
SOUTH AFRICA

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